

Internal Revenue Service

Department of the Treasury
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Date:

October 28, 2004

Legend

Trust =

Decedent =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Spouse =

X =

Date 5 =

Company =

Date 6 =

Dear

This letter responds to your letter, dated July 22, 2004, and prior correspondence requesting extensions of time under §§ 2652(a)(3) and 2654 of the Internal Revenue Code, § 20.2056(b)-7(b)(2)(ii) of the Estate Tax Regulations, and § 301.9100-1 of the Procedure and Administration Regulations to sever the qualified terminable interest property (“QTIP”) portion of Trust into exempt and non-exempt trusts for purposes of the Generation-Skipping Transfer (“GST”) Tax and to make a “reverse” QTIP election with respect to the exempt trust.

The facts submitted and representations made are summarized as follows: Decedent created Trust on Date 1. Decedent amended Trust on Date 2. Trust was amended and restated in its entirety on Date 3. Prior to her death, Decedent

transferred the vast majority of her assets to Trust. Decedent died on Date 4, survived by Spouse, four children, and more remote issue. There was no probate proceeding and no personal representative was appointed.

Section 4.1 of the Trust Agreement as revised on Date 3 provides that during Decedent's life, the trustee shall pay the net income to Decedent or as Decedent directs. Upon Decedent's disability, the trustee, in its discretion, shall apply the income for Decedent's benefit.

Section 4.2 provides that the trustee may pay to Decedent or apply for Decedent's benefit amounts of principal (even to the exhaustion of the trust) as the trustee, in the trustee's discretion, deems necessary or advisable to maintain Decedent's customary standard of living.

Section 4.3(b) provides that if Spouse survives Decedent, the trustee shall administer the remaining principal as Trust A, Spouse's Trust.

Section 4.6 provides that after Decedent's death, the trustee shall pay the net income from Trust A to Spouse for his life. Section 6.1 provides that when income is required to be distributed to a beneficiary, income payments shall be made at least quarterly.

Section 4.8 provides that the trustee may pay principal from Trust A to Spouse from time to time (even to the exhaustion of the trust) as necessary to provide for the spouse's health, education, and support in his accustomed manner of living.

Section 4.10 provides that upon Spouse's death, the trustee shall distribute the remaining principal of Trust A as Spouse appoints by will. This appointment may only be exercised in favor of Decedent's descendants (other than the powerholder). If this power of appointment is not exercised or to the extent it is not effectively exercised, then upon the death of Spouse, the trustee shall divide and distribute the remaining trust assets as provided in Article V.

Section 7.30 provides that the trustee has the powers to divide the trust assets into two or more separate portions or trusts with substantially identical terms and conditions to allocate assets between them in order to simplify administration for GST tax purposes, to segregate assets for management purposes, or to meet other trust objectives; and to combine portions or trusts that have been previously divided.

The trustees of Trust represent that a Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return ("estate tax return"), was timely filed for Decedent's estate. An election to treat certain Trust A assets as QTIP was made on Schedule M. The value of the Trust A assets for which QTIP treatment was elected was listed as \$x on Decedent's estate tax return. Trust A was not listed on Schedule R. The estate received a closing letter on Date 5.

The estate tax return for Decedent's estate was prepared by an employee of Company. Company is a co-trustee of Trust A. The employee inadvertently failed to advise the trustee of Trust A of the need to sever the trust and to make a reverse QTIP election in order to fully utilize Decedent's remaining GST exemption. Spouse died on Date 6 without exercising the special power of appointment granted to him over the Trust A assets. The errors on Decedent's estate tax return were discovered during the administration of Spouse's estate.

The trustees of Trust A have requested extensions of time to sever the QTIP portion of the trust into a GST exempt trust and a non-exempt GST trust and to make a reverse QTIP election with respect to the exempt trust.

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2056(a) provides that, for purposes of the tax imposed by § 2001, the value of the taxable estate is to be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes or has passed from the decedent to the surviving spouse.

Section 2056(b)(1) provides the general rule that no deduction shall be allowed for an interest passing to the surviving spouse if, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, the interest will terminate or fail.

Section 2056(b)(7)(A) provides that, in the case of qualified terminable interest property, the entire property shall be treated as passing to the surviving spouse for purposes of § 2056(a), and no part of the property shall be treated as passing to any person other than the surviving spouse for purposes of § 2056(b)(1)(A).

Section 2056(b)(7)(B)(i) defines "qualified terminable interest property" as property: (1) which passes from the decedent, (2) in which the surviving spouse has a qualifying income interest for life, and (3) to which an election under § 2056(b)(7)(B)(v) applies.

Section 20.2056(b)-7(b)(2)(i) provides that a QTIP election may relate to all or any part of the property for which the surviving spouse has a qualifying income interest for life, provided that any partial election must be made with respect to a fractional or percentage share of the property so that the elected portion reflects its proportionate share of the increase or decrease in value of the entire property for purposes of applying §§ 2044 or 2519. The fractional or percentage share may be defined by formula.

Section 20.2056(b)-7(b)(2)(ii) provides that a trust may be divided into separate trusts to reflect a partial election that has been made, or is to be made, if authorized under the governing instrument or otherwise permissible under local law. Any such division must be accomplished no later than the end of the period of estate administration. If, at the time of the filing of the estate tax return, the trust has not yet been divided, the intent to divide the trust must be unequivocally signified on the estate tax return. Although the division of the trust must be done on a fractional or percentage basis to reflect the partial election, the separate trusts do not have to be funded with a pro rata portion of each asset held by the undivided trust. A trust may be divided only if the fiduciary is required, either by applicable local law or by the express or implied provisions of the governing instrument, to divide the trust on the basis of the fair market value of the assets of the trust at the time of the division.

Section 2601 imposes a tax on every generation-skipping transfer.

Section 2611(a) provides that the term “generation-skipping transfer” means: (1) a taxable distribution; (2) a taxable termination; and (3) a direct skip.

Section 2631(a) provides that for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 (adjusted for inflation under § 2631(c)), that may be allocated by such individual (or by his executor) to any property with respect to which such individual is the transferor.

Section 2632(a)(1) provides that any allocation by an individual of his GST exemption under § 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for such individual’s estate (determined with regard to extensions), regardless of whether such a return is required to be filed.

Section 2632(e)(1) (designated as § 2632(c)(1) at the time of Decedent’s death) provides that, in general, any portion of an individual’s GST exemption which has not been allocated within the time prescribed by § 2632(a) shall be deemed to be allocated as follows – (A) first, to property which is the subject of a direct skip occurring at the individual’s death, and (B) second, to trusts with respect to which the individual is the transferor and from which a taxable distribution or taxable termination might occur at or after the individual’s death.

Section 26.2632-1(d)(2) of the Generation-Skipping Transfer Tax Regulations provides, in relevant part, that no automatic allocation of GST exemption is made to a trust that will have a new transferor with respect to the entire trust prior to the occurrence of any GST with respect to the new trust.

Section 2652(a)(1) provides, in relevant part, that for purposes of chapter 13, the term “transferor” means – (A) in the case of any property subject to the tax imposed by chapter 11, the decedent, and (B) in the case of any property subject to the tax imposed

by chapter 12, the donor. An individual shall be treated as transferring any property with respect to which the individual is the transferor.

Section 2652(a)(3) provides that in the case of – (A) any trust with respect to which a deduction is allowed to the decedent under § 2056 by reason of subsection (b)(7) thereof, and (B) any trust with respect to which a deduction to the donor spouse is allowed under § 2523 by reason of subsection (f) thereof, the estate of the decedent or the donor spouse, as the case may be, may elect to treat all of the property in such trust for purposes of chapter 13 as if the election to be treated as qualified terminable interest property had not been made.

Section 26.2652-2(b) provides that a “reverse” QTIP election is made on the return on which the QTIP election is made.

Section 2654(b) provides that for purposes of the GST tax – (1) the portions of a trust attributable to transfers from different transferors shall be treated as separate trusts, and (2) substantially separate and independent shares of different beneficiaries in a trust shall be treated as separate trusts. Except as provided in the preceding sentence, nothing in chapter 13 is to be construed as authorizing a single trust to be treated as two or more trusts.

Section 26.2654-1(b)(1) provides that the severance of a trust that is included in the transferor’s gross estate (or created under the transferor’s will) into two or more trusts is recognized for purposes of chapter 13 if – (i) the trust is severed pursuant to a direction in the governing instrument providing that the trust is to be divided upon the death of the transferor; or (ii) the governing instrument does not require or otherwise direct severance but the trust is severed pursuant to discretionary authority granted either under the governing instrument or under local law; and (A) the terms of the new trust provide in the aggregate for the same succession of interests and beneficiaries as are provided in the original trust; (B) the severance occurs (or a reformation proceeding, if required, is commenced) prior to the date prescribed for filing the federal estate tax return (including extensions actually granted) for the estate of the transferor; and (C) either – (1) the new trusts are severed on a fractional basis. If severed on a fractional basis, the separate trusts need not be funded with a pro rata portion of each asset held by the undivided trust. The trusts may be funded on a non pro rata basis provided funding is based on either the fair market value on the date of funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the valuation date to the date of funding; or (2) if the severance is required (by the terms of the governing instrument) to be made on the basis of a pecuniary amount, the pecuniary payment is satisfied in a manner that would meet the requirements of § 26.2654-1(a)(ii) if it were paid to an individual.

Section 301.9100-1(c) provides that the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make a regulatory election, or a statutory election (but no more than six months

except in the case of a taxpayer who is abroad), under all subtitles of the Internal Revenue Code except subtitles E, G, H, and I.

Section 301.9100-3(a) provides that, in general, requests for extensions of time for regulatory elections that do not meet the requirements of § 301.9100-2 must be made under the rules of § 301.9100-3.

Requests for relief under § 301.9100-3 will be granted when the taxpayer provides the evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the government.

Section 301.9100-3(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or to advise the taxpayer to make, the election.

Based on the facts submitted and the representations made, the requirements of §§ 301.9100-1 and 301-9100-3 have been met. Therefore, an extension of time is granted until 60 days from the date of this letter to sever the QTIP portion of Trust A into a GST exempt trust and a GST non-exempt trust and to make a “reverse” QTIP election under § 2652(a)(3) with respect to the GST exempt trust. The extensions of time granted in this letter do not extend the time to make an allocation of Decedent’s remaining GST exemption. As a result of the severance of Trust A and the “reverse” QTIP election with respect to the GST exempt trust, Decedent’s remaining GST exemption will be allocated in accordance with the rules provided in § 2632(e)(1).

A supplemental Form 706 should be filed on behalf of Decedent’s estate with the Internal Revenue Service Center, Cincinnati, Ohio 45999. The supplemental Form 706 should list on Schedule M the value of the assets for which a QTIP election was made. In addition, the “reverse” QTIP election for the GST exempt trust should be made on Schedule R. A copy of this letter should be attached to the supplemental Form 706. A copy is enclosed for this purpose.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings it is subject to verification on examination.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer's representative.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Heather C. Maloy

Heather C. Maloy
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

Copy of this Letter

Copy for § 6110 purposes

cc: